Realvest Properties Sdn Bhd v Co-operative Central Bank Ltd (In receivership)

FEDERAL COURT (KUALA LUMPUR) — CIVIL APPEAL NO 02-207-92
CHONG SIEW FAI CJ (SABAH & SARAWAK), PEH SWEE CHIN AND MOHAMED DZAIDDIN FCJJ
13 MAY 1996

Land Law *— Charge — Order for sale — Validity — Loan granted by co-operative society to its member — Loan to be utilized by another company — Whether loan void for being ultra vires of s 30 of Co-operative Societies Act 1948 — Co-operative Societies Act 1948 s 30*

Land Law *— Charge — Order for sale — Validity — Third party charge — Loan granted by co-operative society to its member — Loan to be utilized by another company — Co-operative society had full knowledge that member was only agent of company — Whether chargor or company liable for loan*

Contract *— Interest — Imposition of default interest — On sum in arrears which comprised principal and capitalized interest — Default interest at the rate of 20% paid side by side with interest calculated by prescribed rate of interest of 14.5% per annum on same money lent or owed for the same span of time — Whether amounted to penalty under s 75 of the Contracts Act 1950 — Whether enforceable — Contracts Act 1950 s 75*

Contract *— Penalty clause — Imposition of default interest — Whether amounted to penalty — Whether void — Contracts Act 1950 s 75*

The respondent in this case was a co-operative society registered under the Co-operative Societies Act 1948 ('the co-operative society'). In consideration of a loan of RM3m to one Encik Khalid bin Ramlee who was a member of the co-operative society ('the borrower'), the appellant ('the chargor') charged a piece of land in favour of the co-operative society as security. It was common ground that the loan was to be utilized by a company called Kemajuan Perkasa Sdn Bhd ('the company'). The provisions for default interest were annexed to the instrument of charge (Form 16B). Pursuant to cl 3.1 of the annexure, interest on the loan was prescribed at the rate of 14.5% per annum on monthly rests ('the prescribed rate'). However, cl 3.2 further provided that in the event that any amount due, whether of principal or interest, was not received by the co-operative society on the due date, 'the chargor shall pay interest at the rate of one and one-third (1⅓) times the normal ruling rate of interest on the sum in arrears calculated retrospectively from the due date of such default until the date of the payment of the amount thereof' ('the additional interest'). The chargor later defaulted, and the co-operative society obtained a statutory order for sale on 10 April 1992 as chargee of the land. The land was subsequently sold by public auction, and the proceeds of sale was paid to the co-operative society. The chargor appealed against the order of sale, on the grounds that: (i) the loan was void for being ultra vires of s 30 of the Co-operative Societies Act 1948 ('the

Co-operative Societies Act'), as the actual borrower, ie the company, was not a member of the co-operative society; (ii) the party liable should have been the company as the co-operative society had full knowledge that the borrower was only an agent of the company; and (iii) the co-operative society had charged additional interest on the sum in arrears (which comprised principal and capitalized interest) pursuant to cl 3.2 in addition to the interest calculated by means of the prescribed rate of interest pursuant to cl 3.1 payable before such default and continuing to be payable after such default, and this amounted to a penalty which was irrecoverable under s 75 of the Contracts Act 1950 ('the Contracts Act').

Held, ordering that the appeal be dismissed, save that the amount of default interest computed by virtue of cl 3.2 of the annexure to the charge be refunded to the chargor:

(1) The argument of knowledge of agency tending to contradict or vary the charge instrument was inadmissible and was without avail to the chargor, which had executed what was commonly known as a 'third party charge' (see p 468A–B).

(2) Section 30(1)(a) of the Co-operative Societies Act empowers a registered society to make loans to its members and it does not specify to what purpose such a loan should be utilized. The loan was thus valid and was enforceable against the chargor who provided the security for the loan (see p 467G); *Co-operative Central Bank v Gayabaru Construction* (Kuala Lumpur High Court Originating Summons No 1085/1985) (unreported) followed.

(3) Pursuant to s 75 of the Contracts Act, if a sum is named in a contract as the amount to be paid in case of breach of such contract, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach is entitled to receive from the party who has broken the contract reasonable compensation not exceeding the amount so named or the penalty stipulated for (see p 469F).

(4) Default interest may or may not be a penalty, depending on circumstances. Illustration (d) of s 75 of the Contracts Act gives rise to a clear implication that default interest rate must be exorbitant in order that it be caught by s 75 (see p 470D, F).

(5) The provision of default interest in a contract would still be interpreted according to common law as to whether it is liquidated damages or a penalty, subject to provisions of written law in s 75 of the Contracts Act. The 'Explanation' and 'illustration (d)' in s 75 are by no means capable of supplanting in toto the common law on the questions of penalty and liquidated damages (see p 470H–I).

(6) The essence of a penalty is a stipulated payment in terrorem of the party breaching the contract, whereas in liquidated damages, it is a genuine pre-estimate by both parties of the damages for

such breach of contract (see p 471B); *Dunlop Pneumatic Tyre Co v New Garage & Motor Co* [1915] AC 79 followed.

(7) Ordinarily, in provisions for loans of money, if default is made by the borrower, the borrower is made to pay increased interest by means of a higher rate of interest in place of the lower rate of interest prevailing or payable before default. Therefore, arrears arising from default are subject to one *single* payment of interest still, though at a higher rate after default. Such default interest, if made payable *from* the date of contract (as distinct from the date of default), always amounts to a penalty (see p 471F); *Sundar Koer v Raj Sham Krishen* (1906) 34 IA 9 followed.

(8) Clause 3.2 of the annexure to the charge in question was void and unenforceable by virtue of s 75 of the Contracts Act, and the interest calculated by virtue of cl 3.2 was irrecoverable. The element of 'additional money payment' was involved, in that a default interest of 20% per annum which was chargeable separately and additionally on arrears comprising principal and interest, became payable on default. Further, it was clear from the evidence that the default interest of 20% per annum was paid, side by side with the interest calculated by prescribed rate of interest of 14.5% per annum on the same money lent or owed for the same span of time (see p 472D–G), *Sundar Koer v Raj Sham Krishen* (1906) 34 IA 9 followed.

(9) The established measure of damages payable by a borrower in such default is damages for loss of use of fund or money, which was the sum of money (comprising principal including capitalized principal and interest not yet capitalized) which was in arrears as to evoke cl 3.2 for charging default interest. However, damages for the loss of use of such money has not been proved in this case. It followed that the court could not make any 'reasonable compensation not exceeding ... the penalty stipulated for', according to s 75 of the Contracts Act in this case (see p 472G–I); *Selva Kumar a/l Murugiah v Thiagarajah a/l Retnasamy* [1995] 3 MLJ 817 distinguished.

(10) In view of the court finding cl 3.2 void and the said failure to prove damages for loss of use of the money in question, the default interest charged by virtue of cl 3.2 would have to be deducted from the amount of repayment to the co-coperative society by the chargor (see p 473A).

[Bahasa Malaysia summary

Penentang dalam kes ini merupakan sebuah koperasi yang didaftarkan di bawah Akta Koperasi 1948 ('koperasi tersebut'). Sebagai balasan untuk satu pinjaman sebanyak RM3 juta kepada seorang yang bernama Encik Khalid bin Ramlee yang merupakan seorang ahli koperasi tersebut ('peminjam'), perayu ('penggadai') telah menggadai sebidang tanah kepada koperasi itu sebagai cagaran. Adalah diketahui umum bahawa pinjaman itu akan digunakan oleh sebuah syarikat yang

dikenali sebagai Kemajuan Perkasa Sdn Bhd ('syarikat tersebut'). Peruntukan bagi faedah ingkar telah dilampirkan dengan instrumen gadaian (Borang 16B). Menurut fasal 3.1 lampiran tersebut, faedah ke atas pinjaman itu ditetapkan pada kadar 14.5% setahun pada rehat bulanan ('kadar yang ditetapkan'). Namun demikian, fasal 3.2 selanjutnya memperuntukkan bahawa sekiranya sebarang amaun yang harus dibayar, sama ada wang pokok atau faedah, tidak diterima oleh koperasi tersebut pada tarikh cukup matang, 'penggadai harus membayar faedah pada kadar satu dan satu per tiga ($1\frac{1}{3}$) kali kadar faedah semasa biasa atas jumlah tunggakan yang sudah dihitung secara kebelakangan dari tarikh cukup matang keingkaran demikian sehingga tarikh bayaran amaun tersebut' ('bunga tambahan'). Penggadai kemudiannya ingkar, dan koperasi tersebut telah memperolehi satu perintah jualan statutori pada 10 April 1992 sebagai pemegang gadaian tanah. Tanah itu kemudiannya dijual menerusi lelong awam, dan hasil jualan dibayar kepada koperasi tersebut. Penggadai merayu terhadap perintah jualan, atas alasan bahawa: (i) pinjaman itu adalah tak sah atas sebab ia ultra vires s 30 Akta Koperasi 1948 ('Akta Koperasi'), oleh kerana peminjam sebenar, iaitu syarikat tersebut, bukanlah ahli koperasi; (ii) pihak yang bertanggungan seharusnya merupakan syarikat tersebut oleh kerana koperasi tersebut mempunyai pengetahuan penuh bahawa peminjam hanyalah ejen syarikat tersebut; dan (iii) koperasi tersebut telah mengenakan faedah tambahan ke atas jumlah tunggakan (yang terdiri daripada faedah utama dan faedah modal) menurut fasal 3.2 di samping faedah yang sudah dihitung melalui kadar faedah yang ditetapkan mengikut fasal 3.1 yang harus dibayar sebelum keingkaran dan harus dibayar secara berterusan selepas keingkaran, dan ini merupakan satu penalti yang tidak boleh ditebus di bawah s 75 Akta Kontrak 1950 ('Akta Kontrak').

Diputuskan, memerintahkan supaya rayuan ditolak, kecuali amaun faedah ingkar yang dihitung mengikut fasal 3.2 lampiran gadaian tersebut dibayar balik kepada penggadai:

(1) Hujah penggadai bahawa koperasi tersebut mempunyai pengetahuan tentang ejensi yang berkenaan dalam usaha mereka untuk menyangkal atau mengubah instrumen gadaian adalah tak boleh diterima dan tidak boleh diguna oleh penggadai yang telah melaksanakan apa yang diketahui umum sebagai suatu 'gadaian pihak ketiga' (lihat ms 468A–B).

(2) Seksyen 30(1)(a) Akta Koperasi memberi kuasa kepada suatu pertubuhan berdaftar untuk membuat pinjaman kepada ahli-ahlinya dan ia tidak menyatakan secara spesifik untuk tujuan apakah pinjaman seperti itu harus digunakan. Oleh yang demikian, pinjaman itu adalah sah dan boleh dikuatkuasakan terhadap penggadai yang menyediakan cagaran untuk pinjaman (lihat ms 467G); *Co-operative Central Bank v Gayabaru Construction* (Saman Pemula Mahkamah Tinggi Kuala Lumpur No 1085/1985) (tidak dilaporkan) diikut.

(3) Menurut s 75 Akta Kontrak, jika suatu jumlah telah disebutkan dalam kontrak itu sebagai amaun yang mesti dibayar jika berlakunya kemungkiran kontrak, atau jika kontrak itu mengandungi apa-apa penetapan yang lain secara penalti, pihak yang mengadu tentang kemungkiran berhak mendapat daripada pihak yang memungkiri kontrak itu pampasan yang munasabah yang tidak melebihi amaun yang disebutkan itu atau penalti yang telah ditetapkan untuknya (lihat ms 469F).

(4) Faedah ingkar boleh atau tidak boleh merupakan penalti, bergantung kepada keadaan. Misalan (d) s 75 Akta Kontrak menimbulkan implikasi jelas bahawa kadar faedah ingkar mestilah sangat tinggi supaya dirangkumi oleh s 75 (lihat ms 470D, F).

(5) Peruntukan faedah ingkar dalam sesuatu kontrak masih harus ditafsir mengikut common law sama ada ia merupakan ganti rugi jumlah tertentu atau penalti, tertakluk kepada peruntukan undang-undang bertulis dalam s 75 Akta Kontrak. 'Huraian' dan 'misalan (d)' dalam s 75 tidak berupaya mengambil tempat common law secara in toto atas persoalan penalti dan ganti rugi jumlah tertentu (lihat ms 470H–I).

(6) Inti pati sesuatu penalti ialah suatu bayaran in terrorem oleh pihak yang memungkiri kontrak, manakala dalam ganti rugi jumlah tertentu, pra-anggaran sebenar oleh kedua-dua pihak bagi kemungkiran kontrak demikian dibuat (lihat ms 471B); *Dunlop Pneumatic Tyre Co v New Garage & Motor Co* [1915] AC 79 diikut.

(7) Biasanya, dalam peruntukan pinjaman wang, jika peminjam ingkar, peminjam dikehendaki membayar faedah yang lebih tinggi berikutan dengan kadar faedah yang lebih tinggi yang menggantikan kadar bunga lebih rendah atau yang mesti dibayar sebelum keingkaran. Oleh yang demikian, tunggakan yang timbul daripada keingkaran adalah tertakluk kepada satu bayaran *tunggal* faedah, walaupun pada kadar yang lebih tinggi selepas keingkaran. Faedah ingkar seperti itu, jika harus dibayar *dari* tarikh kontrak (berbanding dengan dari tarikh keingkaran), selalunya merupakan penalti (lihat ms 471F); *Sundar Koer v Raj Sham Krishen* (1906) 34 IA 9 diikut.

(8) Fasal 3.2 lampiran gadaian yang berkenaan adalah terbatal dan tidak boleh dikuatkuasakan mengikut s 75 Akta Kontrak, dan faedah yang dihitung menurut fasal 3.2 tidak boleh ditebus. Unsur 'bayaran wang tambahan' adalah terbabit, iaitu faedah ingkar sebanyak 20% setahun yang boleh dikenakan secara berasingan dan tambahan ke atas tunggakan yang terdiri daripada wang pokok dan faedah yang perlu dibayar atas keingkaran. Tambahan pula, adalah jelas daripada bukti bahawa faedah ingkar sebanyak 20% setahun telah dibayar, di samping faedah yang dihitung melalui kadar faedah yang ditetapkan pada 14.5% setahun ke atas wang yang sama yang dipinjam atau terhutang bagi jangka masa yang sama (lihat ms 472D–G); *Sundar Koer v Raj Sham Krishen* (1906) 34 IA 9 diikut.

(9) Sukatan ganti rugi yang mesti dibayar oleh peminjam dalam keingkaran begitu adalah ganti rugi untuk kehilangan penggunaan tabung atau wang, iaitu jumlah wang (yang terdiri daripada wang pokok termasuk modal wang pokok dan faedah yang belum dimodalkan) yang tertunggak supaya fasal 3.2 boleh diguna untuk mengenakan faedah ingkar. Walau bagaimanapun, ganti rugi untuk kehilangan penggunaan wang demikian tidak dibuktikan dalam kes ini. Ekoran itu, mahkamah tidak dapat membuat sebarang 'pampasan yang munasabah yang tidak melebihi ... penalti yang telah ditetapkan untuknya', menurut s 75 Akta Kontrak dalam kes ini (lihat ms 472G–I); *Selva Kumar a/l Murugiah v Thiagarajah a/l Retnasamy* [1995] 3 MLJ 817 dibeza.

(10) Memandangkan keputusan mahkamah bahawa fasal 3.2 adalah terbatal dan memandangkan kegagalan koperasi tersebut untuk membuktikan kerugian akibat kehilangan penggunaan wang berkenaan, faedah ingkar yang dikenakan mengikut fasal 3.2 harus ditolak daripada amaun pembayaran balik oleh koperasi tersebut kepada pemegang gadaian (lihat ms 473A).]

Notes

For cases on charges, see 8 *Mallal's Digest* (4th Ed, 1996 Reissue) paras 1408–1564.

Cases referred to

Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd [1914–15] All ER Rep 739

Phonographic Equipment (1958) Ltd & Anor v Muslu [1961] 3 All ER 626

Selva Kumar a/l Murugiah v Thiagarajah a/l Retnasamy [1995] 1 MLJ 817

Sundar Koer v Raj Sham Krishen (1906) 34 IA 9

Co-operative Central Bank v Gayabaru Construction (Originating Summons No 1085/1985) (unreported)

Legislation referred to

Contracts Act 1950 s 75

Co-operative Societies Act 1948 s 30

Appeal from: Originating Summons No S7–24–1479–89 (High Court, Kuala Lumpur)

Renu Zechariah (*Anad & Associates*) for the appellant/defendant.

S Gunavathi (*Nazri Aziz & Wong*) for the respondent/plaintiff.

Cur Adv Vult

Peh Swee Chin FCJ (delivering the judgment of the court): This appeal brings into focus some problems, inter alia, as to whether the charging of additional interest by a bank for default by a borrower is caught by s 75 of the Contracts Act 1950. First, a brief summary of facts and events leading to this appeal will have to be set out. The bank ('the respondent/plaintiff') in this instant case is not an ordinary commercial bank but a co-operative society registered under the Co-operative Societies Act 1948.

The appellant/defendant was the chargor and the respondent/plaintiff the chargee (hereinafter 'the chargor' and 'the chargee' respectively as the case may be). The chargee applied for an order of the sale of land charged to secure money lent to one Khalid bin Ramlee by the chargee. A statutory order of sale was made on 10 April 1992; the charged land was duly sold by public auction and the proceeds of sale had been paid to the chargee pending an appeal against the said order of sale dated 10 April 1992 on several grounds.

First, it was submitted that the charge was void on the ground that though the loan of RM3m in question was made to one Khalid bin Ramlee — a member of the co-operative society which was the chargee in this case — it was, in fact, a loan taken and utilized by a company called Kemajuan Perkasa Sdn Bhd of which the said Khalid bin Ramlee was an agent, a fact known to the chargee at all material times (the company is hereinafter referred to as 'the said company'). The said company was the actual borrower, the said Khalid bin Ramlee a nominal one who became a member of the chargee (ie the Co-operative Bank) for the purpose of obtaining the loan, thereby rendering the loan void for being ultra vires by contravening s 30 of the Co-operative Societies Act 1948.

Very briefly, the chargee relied on a passage which was accepted by the court below from an unreported judgment of Siti Norma Yaacob J under the name of *Co-operative Central Bank v Gayabaru Construction*, at p 2, in the High Court at Kuala Lumpur (Originating Summons No 1085/1985) on similar facts and the passage says:

> Since s 30(1)(a) of the (Co-Operative Societies) Act empowers a registered society to make loans to its members, I do not see anything objectionable to the plaintiff granting the loan to Seah who, after all, is one of its members. As the section does not specify to what purpose such a loan should be utilized, I also do not see anything objectionable to Seah using the loan granted by the plaintiff for the benefit of the defendant of which he is its managing director. As lending money to Seah must be one of the objects of the plaintiff to which s 4 of the Act applies, I hold that the loan is valid and is enforceable against the defendant, the chargor, who provided the security for the loan.

We approve the dictum as stating the correct legal position on facts there similar to those as found in the present appeal. This thus disposes of the first point.

The further submission for the chargor was to the effect that as Khalid bin Ramlee was an agent of the said company to the full knowledge of the chargee, the party liable to the chargee should have been the said

company. The chargor, not being the said company, was not liable. Here, the chargor had expressly and in writing charged the land in question to the chargee in consideration of money lent to the said Khalid bin Ramlee — this argument or evidence of knowledge of agency described above tending to contradict or vary the charge instrument is inadmissible and is without avail to the chargor, which had executed what is commonly known as a 'third party charge'.

The third point raised is of considerable importance. It is about additional interest charged by the chargee — or for that matter by any financial institution — for default of a borrower in the payment of any instalment of money lent further and in addition to the interest chargeable already with the stipulated rate prior to such default and continuing to be chargeable normally on such money lent.

The provision for default interest in this case is unusual. First, the relevant clauses as annexed to the instrument of charge (Form 16B) by means of an annexure are as follows:

> 3.1 *Interest*
>
> The chargor shall pay to the bank interest on the loan at the rate of FOURTEEN POINT FIVE PER CENTUM (14.5%) per annum on monthly rests (hereinafter referred to as 'the prescribed rate' which expression shall include such other rate or rates which the bank may at any time and from time to time stipulate). All interest due to the bank in respect of the loan shall be kept current.
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> 3.2 *Additional Interest*
>
> In the event that any amount due under this agreement (whether of principal or interest or otherwise including interest due under this article) is not received by the bank on the due date, the chargor shall pay to the bank interest at the rate of ONE AND ONE-THIRD(1⅓) times the normal ruling rate of interest on the sum in arrears calculated retrospectively from the due date of such default until the date of the payment of the amount thereof.
>
> 3.3 *Variation of Interest Rate*
>
> Notwithstanding the provisions relating to the rate of interest as hereinbefore provided the bank shall be entitled at any time and from time to time to vary at its discretion such rate of interest by serving a notice in writing on the borrower and the chargor of its intention and such amended rate of interest shall be payable as from the date specified in the said notice. Service of such notice shall be effected in the same manner as a notice demanding payment of the balance due as herein provided.

Looking at cl 3.1, it provides for the 'starting rate' of interest at 14.5% pa and also on 'monthly rests'. There is nothing unusual or anything objectionable in this provision and the same can be said with regard to cl 3.3, a common clause which provides for the right of the bank to vary the rate of interest as stipulated from time to time.

However, one cannot say the same about cl 3.2. Given the ordinary and natural meaning, one has feared that cl 3.2 would mean, prima facie,

that under it another separate, distinct or additional amount of interest will be demanded on a sum in arrear (such sum itself comprises principal and capitalized interest) in addition to an anterior and earlier amount of interest calculated by means of the stipulated normal rate of interest already provided by cl 3.1 payable before such default and continuing to be payable after such default normally in the usual course of things.

Such fear was confirmed from the evidence and submission of learned counsel that another separate and distinct amount of interest was indeed charged and made payable in addition to the earlier and separate amount of stipulated interest charged and made payable too. We ascertained this fact twice, if not thrice, from learned counsel for the chargee and in fact, our attention was drawn by her to p 153 of the appeal record (parts A, B and C) where, for example, in pursuance of the said cl 3.2, such default interest of 20% pa charged additionally and separately (ie at 1⅓ times the normal prescribed rate), was set out therein together with another amount of interest calculated by means of the stipulated rate of interest of 14.5% pa seen side by side both amounts of interest covering the same period of 1 January 1984 to 31 December 1984 and on the same sum in arrear.

It was submitted both in the court below and before us that such default interest so calculated in pursuance of the said cl 3.2 and as shown in the manner aforesaid was caught by s 75 of the Contracts Act 1950 (hereinafter 'the said s 75') and was a penalty and therefore irrecoverable.

The relevant part of the said s 75, thus raised, has to be set out as follows:

> When a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach is entitled, whether or not actual damage or loss is proved to have been caused thereby, to receive from the party who has broken the contract reasonable compensation not exceeding the amount so named or, as the case may be, the penalty stipulated for.
>
> *Explanation* — A stipulation for increased interest from the date of default may be a stipulation by way of penalty.
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> ...
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> *ILLUSTRATIONS*
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> (a) ...
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> (b) ...
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> (c) ...
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> (d) A gives B a bond for the repayment of $1,000 with interest at 12 per cent at the end of six months, with a stipulation that, in case of default, interest shall be payable at the rate of 75 per cent from the date of default. This is a stipulation by way of penalty, and B is only entitled to recover from A such compensation as the court considers reasonable.

The said s 75 has been explained generally by this court in *Selva Kumar a/l Murugiah v Thiagarajah a/l Retnasamy* [1995] 1 MLJ 817, for its legal effect and meaning, but the question of increased interest included in the said s 75 itself was not dealt with as it was not an issue there but the question has to be dealt with now.

There has been a great deal of litigation in India over this section in connection with increased interest for default and to such cases there, we are naturally inclined.

Looking at the section, any increased interest for default may very well be 'a sum named in the contract as the amount to be paid in case of such breach ...'. However, the proviso there, to quote: 'Explanation — A stipulation for increased interest from the date of default *may* be a stipulation by way of penalty', was enacted by way of amendment in India to provide a modification to such a probable interpretation. We, of course, imported the said s 75 complete with such amendment in 1950. The meaning is clear that such a stipulation for default interest may or may not be a penalty, depending on circumstances. One may ask, 'what circumstances?' The answer is apparently found — partially, at least — in illustration (d) as set out above. Such modification, instead of making such default interest through and through a penalty, must have been intended to protect commercial banks which have always been in the habit and business of charging default interest. Commercial banks have to be protected as they are vital to any orderly national commerce, inter alia.

We now look at the illustration (d) which refers to default interest being increased from 12% to 75% from date of default. The illustration gives rise to a clear implication that default interest rate must be exorbitant in order that it be caught by the said s 75.

The reluctance of a large number of Indian courts to recognize such default interest as anything having the characteristic of 'the sum named in the contract as the amount to be paid' on breach and the subsequent amendment by way of such modification mentioned above has this curious result. While the object of enacting the said s 75 was to abolish the difference between penalty and liquidated damages so that every sum named in the contract to be paid on breach would be treated as unenforceable on the basis of such sum being a penalty in every case, the amendment by way of the said modification brought back such distinction only in the case of interest or default interest, ie increased interest payable on default. This is evident from the wording of the 'Explanation' set out above, notably the words 'may' and 'penalty' therein. The use of the word 'penalty' therein must have been deliberate. Thus, in construing the effect of the provision of default interest in a contract, such specific provision would still be interpreted according to common law as to whether it is liquidated damages or a penalty, subject to and qualified by provisions of written law in the said s 75, ie the 'Explanation' and the 'illustration (d)' therein which are, by no means from their nature, capable of supplanting in toto the common law on the questions of penalty and liquidated damages.

A It is not proposed to write in detail the difference between liquidated damages and a penalty in a contract but only to skim over it sufficiently for the purpose of this appeal.

The essence of a penalty is a stipulated payment in terrorem of the party breaching the contract whereas in liquidated damages, it is a genuine B pre-estimate by both parties of the damages for such breach of contract, see eg *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd* [1915] 79 at p 87. In *Phonographic Equipment (1958) Ltd & Anor v Muslu* [1961] 3 All ER 626, a contention was there raised that a depreciation clause in a hire-purchase agreement was a penalty and therefore void. Harman LJ, in a very brief concurring judgment, made this observation (at p 632):

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> The court, in my judgment, should be slow to interfere with bargains entered into freely and without pressure. I am not satisfied that this bargain can be described as harsh and unconscionable, and unless it passes the test, I am of opinion that the court should allow it to stand.

D Harman LJ seems to have summed up very accurately the essence of the difference between liquidated damages and penalty. The test is by no means easy in application, and is applicable to a large variety of factual situations for which it will be necessary to refer to a tremendous number of cases. We do not propose to do so. It should be, in brief, closely connected with morality which must have much preoccupied the minds of E the early Lord Chancellors who were then ecclesiastics or priests at the same time.

Reverting to facts in the instant appeal, what we have is something out of the ordinary. Ordinarily, in provisions for loans of money, if default is made by the borrower, the borrower is made to pay increased interest by F means of a higher rate of interest in place of the lower rate of interest prevailing or payable before default. Therefore, arrears arising from default are subject to one *single* payment of interest still, though at a higher rate after default. It has been held or approved by the Privy Council that such default interest, if made payable *from* the date of contract (as distinct from the date of default), always amounts to a penalty. The case in the Privy G Council we have in mind is *Sundar Koer v Raj Sham Krishen* (1906) 34 IA 9 at p 17.

The Privy Council said:

> The Indian courts have invariably held that where (as in the present case) the stipulation is retrospective and the increased interest runs from the date H of the bond and not merely from the date of default, it is always to be considered as a penalty, *because an additional money payment in that case becomes immediately payable* by the mortgagor. Their Lordships accept this view of the statute. (Emphasis added.)

The iatalicized words are crucial to the instant appeal, more of it later. We, I on our part, equally accept the same view.

In that case, questions arose in the taking of accounts between a mortgagor and a mortgagee as to whether certain interest should be allowed. There was a provision in the mortgage for payment of increased

interest of 12% pa (from the stipulated previous rate of 10½% pa) on the money lent to be chargeable and made payable from the date of the execution of mortgage bond till the date of payment should the mortgagor make default in paying interest on the money lent within one year. It was argued that it was a penalty within the meaning of the said section. Such argument was accepted and the Privy Council made the dictum quoted above.

It will be noticed that although the increased rate of 12% pa was by no means exorbitant, the provision was held to be void since such default interest would be calculated from the date of the mortgage (though the default took place quite some time after the date of the mortgage) and not from the date of default. The rub was the additional money payment in that case because it became immediately payable by the mortgagor on default. The additional money payment was that default interest payable at 12% pa from the date of the mortgage to the date of default, and it must have been considered, by implication, as harsh or unconscionable.

Reverting to the instant appeal and having regard to what has been stated in the Privy Council, we have, in hand, the element of 'additional money payment' involved also in that on default, a default interest of 20% pa chargeable separately and additionally on arrears comprising principal and interest, became payable. It will be clear from the evidence, eg at p 153 of the appeal record, that the default interest of 20% pa was paid, side by side with the interest calculated by prescribed rate of interest of 14.5% pa on the same money lent or owed for the same span of time. In other words, a second additional payment of interest on the same money lent or owed, and it became payable in addition to the normal payment of interest on the same money lent or owed at 14.5% pa, well within the ambit of the ratio from *Sunder Koer*'s case.

We therefore hold that cl 3.2 of the annexure to the charge in question is void and unenforceable by virtue of s 75 of the Contracts Act 1950 and the interest calculated by virtue of cl 3.2 is irrecoverable.

The next question is whether in such event the chargee is entitled to receive a 'reasonable compensation not exceeding ... the penalty stipulated for' according to the said s 75 which has been judicially interpreted in *Selva Kumar*. We know that there is an established measure of damages payable by a borrower in such default, which is damages for loss of use of fund or money. Such money in the instant case is the sum of money (comprising principal including capitalized principal and interest not yet capitalized) which was in arrear as to evoke (futilely, in the instant case) cl 3.2 for charging default interest. Such sum in arrear, if it had not been in arrear and had been paid back punctually to the chargee could have been lent to some other person by the chargee — at certain rate of interest for the period while it was in arrear.

Damages for the loss of use of such money has not been proved in this case, so that the court cannot make any award in regard to it following the case of *Kumar*.

In view of the court finding cl 3.2 void and the said failure to prove damages for loss of use of the money in question, the default interest charged by virtue of the said cl 3.2 would have to be deducted from the amount of repayment to the chargee by the chargor.

About the propriety of the legal fees and costs said to be made payable by cl 10.6 to the same annexure, and raised by the chargor in argument before us, it has not been pleaded in the memorandum of appeal and no attempt was made to amend it for this purpose. In the court below, the point was barely touched on by both sides and the grounds of judgment of the court below have not even mentioned it. On appeal, learned counsel for the chargor raised it and the opposing counsel argued against it in a very impromptu and insufficient manner. In the circumstances, in particular, being deprived of the benefit of the learned judge's view on it, and it not having been pleaded in the memorandum of appeal, we decline to decide thereon and would leave it to another day in an appropriate case.

The learned judge has made an order in terms of the originating summons dated 10 July 1989 (encl 1) and prayer (1) therein refers to the outstanding sum of RM6,827,805.43 as at 31 December 1988. The default interest calculated by virtue of the said cl 3.2 would have to be deducted therefrom and the amount so deducted would have to be refunded if it had already been paid to the chargee earlier.

We make the following order:

(1) that the appeal be dismissed save as follows:

(a) that the amount of default interest computed by virtue of cl 3.2 of the annexure to the charge in question be deducted from the sum of RM6,827,805.43 as stated in prayer (1) of the originating summons herein dated 10 July 1989;

(b) that such amount for such deduction be agreed by both parties within one month from the date hereof, failing which the Deputy Registrar of the High Court in question on application by either party, be authorized to determine such amount with an appeal to the judge in chambers if the determination is disputed; and

(c) that such amount, if already paid to the respondent, be refunded within one week from the date of its ascertainment with interest at 4% pa from 10 April 1992 (the date of the order appealed from) to the date of this order, and thereafter at 8% pa to date of refund;

(2) that the appellant do pay the respondent half of the costs of this appeal; and

(3) that the deposit be paid towards the costs but the surplus, if any, be referred to the appellant.

Order accordingly.

Reported by Isabel Liong